

Internal Revenue Service

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In Re:

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B04

PLR-164514-05

Date: APRIL 30, 2007

LEGEND:

Husband	=
Wife	=
Trust	=
Marital Trust	=
Residual Trust	=
County Court	=
Property	=
Bank	=
Daughter 1	=
Daughter 2	=
Daughter 3	=
Grandchild 1a	=
Grandchild 1b	=
Grandchild 2a	=
Grandchild 2b	=
Grandchild 3a	=
Grandchild 3b	=
Grandchild 3c	=
Grandchild 3d	=
Son-in-law	=
State	=
Attorney	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
Date 5	=
State's UTMA	=

State Statute 1 =
State Statute 2 =
State Statute 3 =
State Statute 4 =

Dear :

This is in response to your letter dated December 12, 2005 and other correspondence requesting rulings concerning the income, gift, and generation-skipping transfer (GST) tax consequences of proposed reformatations and modifications of two trusts.

The facts submitted are as follows:

Husband and Wife (collectively the Trustors) established a revocable trust (Trust) on Date 1 (prior to October 21, 1986). Article III of Trust provides that on the death of the first spouse to die, the trustee is to divide the trust estate into three separate trusts: the Survivor's Trust, the Marital Trust, and the Residual Trust.

Article V, paragraph A, provides that from the time of death of the first spouse to die, the trustee is to pay to the surviving spouse, as long as he or she lives, the net income of the Survivor's Trust, the Marital Trust, and the Residual Trust in quarter-annual or more frequent payments.

Article V, paragraph B, provides, in relevant part, that if the trustee considers such income insufficient, the trustee is to pay to or apply for the benefit of the surviving spouse such sums out of the principal of the trusts as are necessary for the surviving spouse's proper health, support, and maintenance.

Article V, paragraph D, provides, in relevant part, that it is the Trustors' intention that the executor of the estate of the first spouse to die, in the executor's sole discretion, make or not make the election provided by section 2056(b)(7)(B)(v) to treat all or a specific portion of the Marital Trust as qualified terminable interest property (QTIP) for the purpose of qualifying all or a specific portion of the trust for the federal estate tax marital deduction.

Article VI sets forth the distribution of the assets held in the Marital Trust and the Residual Trust (trust estate) upon the death of the surviving spouse. The relevant provisions are as follows:

Paragraph A provides that Property is to be distributed outright to Daughter 3. In the event that Daughter 3 is predeceased, to her children share and share alike. If no children, to the residue of this trust [estate]. (Emphasis added).

Paragraph B.1 provides that one-sixth of the trust estate is to be distributed to Bank, in trust, for the benefit of Daughter 1 to be held, administered, and distributed for the rest of her life, or until exhaustion of the funds held in trust. The trustee is to pay to Daughter 1, first from the income and the balance from principal, a sum not to exceed \$1,000 per month. During the existence of the trust, if the trustee considers the income insufficient due to extraordinary expenses and/or increase in the cost of living, the trustee may, in its sole discretion, pay an additional sum to Daughter 1 each month after taking into consideration to the extent the trustee deems advisable, any income or resources of Daughter 1 outside of her trust. If Daughter 1 is predeceased or upon her death, the residue of her trust is to be held in further trust for Grandchild 1a and Grandchild 1b share and share alike or to the survivor. (Emphasis added). Bank is to continue to serve as trustee.

Paragraph B.2 provides that one-sixth of the trust estate is to be distributed to Bank, in trust, for the benefit of Grandchildren 1a and 1b. The trustee is to pay to or apply for the benefit of Grandchildren 1a and 1b, the entire net income of the trust quarter-annually or at more frequent intervals during the existence of the trust. During the existence of the trust, if the trustee considers the income insufficient, the trustee may, in its sole discretion, pay to or apply for the benefit of Grandchildren 1a and 1b as much of the principal of their trust as the trustee, in the trustee's discretion, considers necessary for their proper support, health, maintenance, and education. When Grandchild 1a attains age 25, the trustee is to distribute one-half of the principal to her. When Grandchild 1b attains age 25, the trustee is to distribute the remainder of the trust to her. If either Grandchild 1a or Grandchild 1b is predeceased, to their children by right of representation. If no children, to the survivor of Grandchild 1a and Grandchild 1b. (Emphasis added).

Paragraph B.3 provides that one-sixth of the trust estate is to be distributed outright to Daughter 2. In the event she is predeceased, to her children, share and share alike, or to the survivor of her children. (Emphasis added).

Paragraph B.4 provides that one-sixth of the trust estate is to be distributed to Daughter 2, in trust, for the benefit of Grandchildren 2a and 2b, and to any other child or children born to Daughter 2 and living at the time of our [Husband and Wife's] death, share and share alike, or to the survivors, to be held, administered, and distributed as follows: The trustee is to pay to or apply for the benefit of Grandchildren 2a and 2b, the entire net income of the trust quarter-annually or at more frequent intervals during the existence of the trust. During the existence of the trust, if the trustee considers the income insufficient, the trustee may, in her sole discretion, pay to or apply for the benefit of Grandchildren 2a and 2b as much of the principal of their trust as the trustee, in the trustee's discretion, considers necessary for their proper support, health, maintenance, and education. When Grandchild 2a attains age 25, the trustee is to distribute one-half of the principal to her. When Grandchild 2b attains age 25, the trustee is to distribute

the remainder of the trust to her. If either Grandchild 2a or 2b are predeceased, to their children. If no children, to the survivor of Grandchild 2a or Grandchild 2b. (Emphasis added).

Paragraph B.5 provides that one-sixth of the trust estate is to be distributed outright to Daughter 3. In the event she is predeceased, to her children share and share alike, or to the survivor of her children. (Emphasis added).

Paragraph B.6 provides that one-sixth of the trust estate is to be distributed to Daughter 3, in trust, for the benefit of Grandchild 3a and to any other child or children born to Daughter 3 and living at the time of our [Husband and Wife's] death, share and share alike or to the survivor, to be held, administered, and distributed as follows: The trustee is to pay to or apply for the benefit of Grandchild 3a, the entire net income of the trust quarter-annually or at more frequent intervals during the existence of the trust. During the existence of the trust, if the trustee considers the income insufficient, the trustee may, in her sole discretion, pay to or apply for the benefit of Grandchild 3a as much of the principal of his trust as the trustee, in the trustee's discretion, considers necessary for his proper support, health, maintenance, and education. When Grandchild 3a attains age 25, the trustee is to distribute to Grandchild 3a his share of the principal of his trust. If Grandchild 3a is predeceased, to his children and if no children, this trust shall terminate and the assets shall be transferred to the residue of our [the] trust [estate]. (Emphasis added).

Article VII provides, in relevant part, that during the joint lifetimes of the Trustors, the Trust may be revoked in whole or in part. On the death of the first Trustor to die, the surviving spouse is to have the power to amend, revoke, or terminate the Survivor's Trust, but the Marital Trust and the Residual Trust may not be amended, revoked, or terminated.

Article XII provides that if Husband and Wife for any reason fail to qualify or cease to act as trustees, Bank is appointed successor trustee, with the same effect as though originally named as trustee.

Husband died on Date 2 (prior to January 1, 1987). Following Husband's death, Wife, as trustee, divided Trust into a Survivor's Trust, a Marital Trust, and a Residual Trust. Also, as executrix of Husband's estate, Wife timely filed Husband's estate tax return and elected to treat the Marital Trust as QTIP.

At the time Trust was executed, Husband and Wife had three Daughters, Daughter 1, Daughter 2, and Daughter 3. Daughter 1 had two children, Grandchild 1a and Grandchild 1b. Daughter 2 had two children, Grandchild 2a and Grandchild 2b. Daughter 3 had one child, Grandchild 3a. At the time of Husband's death, Daughter 3 had two additional children, Grandchild 3b and Grandchild 3c. After Husband's death,

Daughter 3 had another child, Grandchild 3d. Daughter 3 died on Date 3, predeceasing Wife.

On Date 4, Wife, in her capacity as trustee of Trust, filed a petition in County Court to reform certain provisions of Article VI that, due to scrivener's error, do not express the Trustors' intentions and to modify other provisions of Article VI because of changed circumstances. On Date 5, County Court entered an order granting the petition, subject to the issuance of a favorable private letter ruling by the Internal Revenue Service.

Reformations Based on Scrivener's Error

The petition alleges that in discussions with Attorney who drafted Trust, the Trustors informed Attorney of their intentions with respect to the trust estate after the death of both spouses and that said intentions were as follows: (1) that Property was to be given to Daughter 3; (2) that the remainder of the trust estate was to be divided into 6 equal shares: one for Daughter 1, one for Daughter 2, one for Daughter 3, one for the children of Daughter 1, one for the children of Daughter 2, and one for the children of Daughter 3; (3) that the children of each daughter should share equally in the share set apart for those children; (4) that the trusts for the grandchildren should be materially similar; (5) that any assets allocated to a grandchild should be held in trust until the grandchild attained the age of 25; and, (6) that if a beneficiary died before receiving full distribution of his or her share, that share should pass to the beneficiary's issue.

In connection with the proceedings, Attorney submitted an affidavit to the County Court, acknowledging that the wording of the Trust instrument did not comport with the intentions expressed to him by the Trustors. The reformations of Article VI based on scrivener's error are as follows:

Paragraph A. As reformed, paragraph A will provide that in the event Daughter 3 predeceases the surviving spouse, Property will pass to her issue by right of representation to be distributed in accordance with Paragraph B.6 (as reformed), which provides for the one-sixth share of the trust estate for the children of Daughter 3. If Daughter 3 is not survived by issue, Property will be distributed to the residue of the trust estate.

Paragraph B.1. As reformed, paragraph B.1 will provide that if Daughter 1 predeceases the surviving spouse, or upon her later death, Daughter 1's trust will pass to her issue by right of representation to be distributed in accordance with paragraph B.2 (as reformed), which provides for the one-sixth share of the trust estate for the children of Daughter 1.

Paragraph B.2. As reformed, paragraph B.2 will provide that one-sixth of the trust estate shall be distributed in equal shares to the descendants of Daughter 1 by

right of representation. The share to be distributed to Grandchild 1a or to Grandchild 1b shall be held and administered as separate trusts for Grandchild 1a and Grandchild 1b, respectively. Bank shall serve as trustee for any separate trust created under paragraph B.2. Trustee shall pay or apply for the benefit of the beneficiary the entire net income of the beneficiary's trust quarter-annually or at more frequent intervals during the existence of the beneficiary's trust. If the trustee considers the income insufficient, the trustee may, in its sole and absolute discretion, pay to or apply for the benefit of the beneficiary as much of the principal of the trust as the trustee considers necessary for the beneficiary's proper support, health, maintenance and education. When the beneficiary attains age 25, the trustee shall distribute the beneficiary's entire trust to the beneficiary. If at the time a trust is established for the beneficiary, the beneficiary has already attained age 25, the trustee shall distribute the entire trust to the beneficiary. If the beneficiary dies before receiving distribution of her entire trust, the balance of the beneficiary's trust shall be distributed by right of representation to the beneficiary's descendants, or, if there are none, to the descendants of Daughter 1, or, if there are none, to the residue of the trust estate.

Paragraph B.3. As reformed, paragraph B.3 will provide that if Daughter 2 predeceases the surviving spouse, Daughter 2's one-sixth share of the trust estate will pass to her issue by right of representation to be distributed in accordance with paragraph B.4 (as reformed), which provides for the one-sixth share of the trust estate for the children of Daughter 2.

Paragraph B.4. As reformed, paragraph B.4 will provide that one-sixth of the trust estate shall be distributed in equal shares to the descendants of Daughter 2 by right of representation. The share to be distributed to Grandchild 2a or to Grandchild 2b shall be held and administered as separate trusts for Grandchild 2a and Grandchild 2b, respectively. Daughter 2 shall serve as trustee for any separate trust created under paragraph B.4. Trustee shall pay or apply for the benefit of the beneficiary the entire net income of the beneficiary's trust quarter-annually or at more frequent intervals during the existence of the beneficiary's trust. If the trustee considers the income insufficient, the trustee may, in her sole and absolute discretion, pay to or apply for the benefit of the beneficiary as much of the principal of the trust as the trustee considers necessary for the beneficiary's proper support, health, maintenance and education. When the beneficiary attains age 25, the trustee shall distribute the beneficiary's entire trust to the beneficiary. If at the time a trust is established for the beneficiary, the beneficiary has already attained age 25, the trustee shall distribute the entire trust to the beneficiary. If the beneficiary dies before receiving distribution of her entire trust, the balance of the beneficiary's trust shall be distributed by right of representation to the beneficiary's descendants, or, if there are none, to the descendants of Daughter 2 or, if there are none, to the residue of the trust estate.

Paragraph B.5. As reformed, paragraph B.5 will provide that if Daughter 3 predeceases the surviving spouse, Daughter 3's one-sixth share of the trust estate will

pass to her issue by right of representation to be distributed in accordance with Paragraph B.6 (as reformed), which provides for the one-sixth share of the trust estate for the children of Daughter 3.

Paragraph B.6. As reformed, paragraph B.6 will provide that one-sixth of the trust estate shall be distributed in equal shares to the descendants of Daughter 3 by right of representation. The share to be distributed to Grandchild 3a or to any other child born to Daughter 3 and living at the time of death of the surviving spouse shall be held and administered for his or her benefit in a separate trust. Daughter 3 shall serve as trustee for any separate trust created under paragraph B.6. Trustee shall pay or apply for the benefit of the beneficiary the entire net income of the beneficiary's trust quarter-annually or at more frequent intervals during the existence of the beneficiary's trust. If the trustee considers the income insufficient, the trustee may, in her sole and absolute discretion, pay to or apply for the benefit of the beneficiary as much of the principal of the trust as the trustee considers necessary for the beneficiary's proper support, health, maintenance and education. When the beneficiary attains age 25, the trustee shall distribute the beneficiary's entire trust to the beneficiary. If at the time a trust is established for the beneficiary, the beneficiary has already attained age 25, the trustee shall distribute the entire trust to the beneficiary. If the beneficiary dies before receiving distribution of his or her entire trust, the balance of the beneficiary's trust shall be distributed by right of representation to the beneficiary's descendants, or, if there are none, to the descendants of Daughter 3, or, if there are none, to the residue of the trust estate.

As drafted, the provisions of Article VI comply with the Trustors' intentions to the extent that they provide for the distribution of the Property to Daughter 3 and the division of the remaining trust estate into six equal shares upon the death of the surviving spouse. Some, but not all, of the provisions show the Trustors' intent that assets allocated to a grandchild be held in trust until the grandchild attains the age of 25. Only paragraph B.2 provides that if a grandchild predeceases the surviving spouse, her share is to pass to her children "by right of representation." However, as a whole, the provisions of Article VI are internally inconsistent and ambiguous in several respects.

For example, under paragraph B.1, if Daughter 1 predeceases the surviving spouse, her one-sixth share of the trust estate (held in trust) is to be held in further trust for Grandchildren 1a and 1b, share and share alike, or to the survivor. However, under paragraphs B.3 and B.5, if either Daughter 2 or Daughter 3 predeceases the surviving spouse, her one-sixth share is to pass to her children, share and share alike, or to the survivor. Also, if Daughter 3 predeceases the surviving spouse, Property is to pass to her children whether or not they have attained the age of 25.

The trusts to be created for the Trustors' grandchildren are unclear in many respects. As noted above, the trust to be created for the children of Daughter 1

specifically names Grandchild 1a and Grandchild 1b as the only beneficiaries, while the trusts to be created for the children of Daughter 2 and Daughter 3 name Grandchild 2a and Grandchild 2b and Grandchild 3a, respectively, but also provide for any other children born to Daughter 2 or Daughter 3 and living at the time of the surviving spouse's death. Moreover, the trusts for the grandchildren provide that the specifically named beneficiaries of each trust are to receive the entire net income of their trust quarter-annually or at more frequent intervals and so much of the principal as the trustee deems necessary, in the trustee's sole discretion, for their proper support, health, maintenance and education. There is no direction as to whether these trusts are to be treated as sprinkling trusts or be divided into separate shares for each grandchild.

Modifications Based on Changed Circumstances

Paragraph B.1, which provides that one-sixth of the trust estate is to be held in trust for Daughter 1 will be modified to provide that the trustee is to pay Daughter 1 \$1,000 per month, and if the trustee determines that such amount is insufficient, the trustee is to pay or apply for the benefit of Daughter 1 such additional amounts of the net income or principal, or both, as the trustee, in its sole discretion, deems necessary for Daughter 1's support, health, maintenance, or education, in her accustomed standard of living. The trustee may take into consideration any income or resources of Daughter 1 outside of her trust.

Paragraph B.6, which provides that one-sixth of the trust estate is to be held in trust for the benefit of the children of Daughter 3, will be modified to provide that son-in-law, Daughter 3's former husband, will serve as trustee and to provide a list of successor trustees to serve in the event that son-in-law is unable to serve. This modification is necessary because of the death of Daughter 3, who was to serve as trustee.

Paragraph B.10 will be added to provide that if a distribution of assets permitted to be made under the provisions of Trust to a beneficiary who is a great-grandchild or more remote descendant of Trustors and who is under the age of 25, the assets are to be distributed to a custodian nominated by the trustee to be held for the benefit of the beneficiary under State's Uniform Transfers to Minors Act (UTMA) until the beneficiary reaches the age of 25.

The trustee represents that no additions, constructive or otherwise, have been made to Marital Trust or Residual Trust since Husband's death.

The following rulings have been requested:

1. Husband's estate will be treated as having made a reverse QTIP election under section 2652(a)(3) with respect to the Marital Trust.
2. The proposed reformations will not cause either the Marital Trust or the Residual Trust to lose its exempt status for purposes of the GST tax.
3. The proposed modifications will not cause either the Marital Trust or the Residual Trust to lose its exempt status for purposes of the GST tax.
4. The proposed reformations will not give rise to any gift tax liability to any party.
5. The proposed modifications will not give rise to any gift tax liability to any party.
6. The proposed reformations will not give rise to any gain or loss or any income tax liability to any party.
7. The proposed modifications will not give rise to any gain or loss or any income tax liability to any party.

Ruling 1

Section 2601 imposes a tax on every generation-skipping transfer (GST), which is defined under section 2611 as a taxable distribution, a taxable termination, or a direct skip.

Under section 1433 of the Tax Reform Act of 1986 (Act), the GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under section 1433(b)(2)(A) of the Act and section 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the tax does not apply to a transfer under a trust that was irrevocable on September 25, 1985, provided no additions (actual or constructive) were made to the trust after that date.

Section 2612(a) provides that a taxable termination means a termination by death, lapse of time, release of a power, or otherwise, of an interest in property held in a trust where the property passes to a skip person. Section 2612(b) provides that a taxable distribution means any distribution from a trust to a skip person other than a taxable termination or a direct skip. Section 2612(c) provides that a direct skip means a transfer subject to a tax imposed by Chapter 11 (the estate tax) or Chapter 12 (the gift tax) of an interest in property to a skip person.

Section 2613 defines a skip person as (1) a natural person who is assigned to a generation that is two or more generations below that of the transferor; (2) a trust in

which all interests are held by skip persons; or (3) a trust where no trust distributions, including those upon termination, may be made to non-skip persons.

Section 2652(a)(1) provides that the term "transferor" means, with respect to property subject to the estate tax, the decedent. Section 2652(a)(3) provides that any trust with respect to which a deduction is allowed to the decedent under section 2056(b)(7) for qualified terminable interest property (QTIP), the estate of the decedent may elect to treat, for purposes of the GST tax, all of the property in the trust as if the section 2056(b)(7) election had not been made. This election is referred to as the "reverse QTIP" election.

Section 26.2601-1(b)(1)(iii) provides that, for purposes of the GST tax, a trust that was irrevocable on September 25, 1985, and that holds qualified terminable interest property by reason of an election under section 2056(b)(7) (made either on, before or after September 25, 1985) is treated in the same manner as if the decedent spouse had made an election under section 2652(a)(3). Thus, transfers from these trusts are not subject to the GST tax, and the decedent spouse is treated as the transferor of the property. This rule does not apply to that portion of the trust that is subject to the GST tax by reason of an addition to the trust occurring after September 25, 1985.

Section 26.2601-1(b)(2) provides that the GST tax does not apply to any generation-skipping transfer under a will or other revocable trust executed before October 22, 1986, provided that the document in existence on October 21, 1986, is not amended at any time after October 21, 1986, in any respect which results in the creation of, or an increase in the amount of, a generation-skipping transfer, and the decedent dies before January 1, 1987. This paragraph also provides that the rules contained in section 26.2601-1(b)(1)(iii) apply to any will or revocable trust within the scope of this paragraph.

In the present case, the Marital Trust and the Residual Trust were not irrevocable on September 25, 1985. The Trust was executed prior to October 22, 1986, and Husband died before January 1, 1987. It is represented that no additions, constructive or otherwise, have been made to Marital Trust or Residual Trust since Husband's death. Accordingly, based on the facts submitted and representations made, we conclude that the Marital Trust and the Residual Trust are within the scope of section 26.2601-1(b)(2) and, therefore, section 26.2601-(b)(1)(iii) applies to the Marital Trust. Thus, Husband will be treated as if he had made a reverse QTIP election under section 2652(a)(3) with respect to the Marital Trust. If there are no additions to the Marital Trust, transfers from the trust will not be subject to the GST tax, and Husband will be treated as the transferor of the property.

Rulings 2 and 3

Section 26.2601-1(b)(4)(i) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the GST tax under section 26.2601-1(b) will not cause the trust to lose its exempt status. The regulation provides that the rules contained in the paragraph are applicable only for purposes of determining whether an exempt trust retains its exempt status for GST tax purposes. The rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of capital gain for purposes of section 1001.

Section 26.2601-1(b)(4)(i)(C) provides that a judicial construction of a governing instrument to resolve an ambiguity in the terms of the instrument or to correct a scrivener's error will not cause an exempt trust to be subject to the GST provisions if: (1) the judicial action involves a bona fide issue; and (2) the construction is consistent with applicable state law that would be applied by the highest court of the state.

Section 26.2601-1(b)(4)(i)(D) provides that a modification will not cause an exempt trust to be subject to the GST tax if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in section 2651) than the person or persons who held the beneficial interest prior to the modification, and the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. A modification of an exempt trust will result in a shift in a beneficial interest to a lower generation beneficiary if the modification can result in either an increase in the amount of a generation-skipping transfer or the creation of a new generation-skipping transfer. A modification that is administrative in nature that only indirectly increases the amount transferred (for example, by lowering administrative costs or income taxes) will not be considered to shift a beneficial interest in the trust.

Section 26.2601-1(b)(4)(i)(E), Example 3 considers a situation where, in 1980, Grantor established an irrevocable trust for the benefit of Grantor's children, A and B, and their issue. The trust is to terminate on the death of the last to die of A and B, at which time the principal is to be distributed to their issue. However, the provision governing the termination of the trust is ambiguous regarding whether the trust principal is to be distributed per stirpes, only to the children of A and B, or per capita among the children, grandchildren, and more remote issue of A and B. In 2002, the trustee files a construction suit with the appropriate local court to resolve the ambiguity. The court issues an order construing the instrument to provide for per capita distributions to the children, grandchildren, and more remote issue of A and B living at the time the trust terminates. The court's construction resolves a bona fide issue regarding the proper interpretation of the instrument and is consistent with applicable state law as it would be interpreted by the highest court of the state. Therefore, the trust will not be subject to the GST tax.

Section 26.2601-1(b)(4)(i)(E), Example 10, considers a situation where the appropriate local court approves a modification of a trust that decreases the number of trustees. The modification pertains to the administration of the trust and does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in section 2651) than the person or persons who held the beneficial interest prior to the modification, and it does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. Therefore, the trust will retain its exempt status.

State Statute 1 provides that a trustee or beneficiary of a trust may petition the court concerning the internal affairs of the trust, including determining questions of construction of a trust instrument, or to determine the existence of the trust.

State Statute 2 provides that when, through fraud or a mutual mistake of the parties, or a mistake of one party, which the other at the time knew or suspected, a written contract does not truly express the intention of the parties, it may be revised, on the application of a party aggrieved, so as to express that intention, so far as it can be done without prejudice to rights acquired by third persons, in good faith and for value.

State Statute 3 provides that a transfer made pursuant to State's UTMA is irrevocable, and the custodial property is indefeasibly vested in the minor, but the custodian has all the rights, powers, duties, and authority provided in this part, and neither the minor nor the minor's legal representative has any right, power, duty, or authority with respect to the custodial property except as provided in this part.

State Statute 4 provides, in relevant part, that the custodian, under State's UTMA, is to transfer in an appropriate manner the custodial property to the minor or to the minor's estate upon the earlier of the following: (1) the time specified in the transfer or (2) the minor's death. In our case, the time specified in the transfer is when the minor attains age 25.

In Commissioner v. Estate of Bosch, 387 U.S. 456 (1967), the Court considered whether a state trial court's characterization of property rights conclusively binds a federal court or agency in a federal estate tax controversy. The Court concluded that the decision of a state trial court as to an underlying issue of state law should not be controlling when applied to a federal statute. Rather, the highest court of the state is the best authority on the underlying substantive rule of state law to be applied in the federal matter. If there is no decision by that court, then the federal authority must apply what it finds to be state law after giving "proper regard" to the state trial court's determination and to relevant rulings of other courts of the state. In this respect, the federal agency may be said, in effect, to be sitting as a state court.

In this case, an examination of the relevant trust instruments and representations of the parties indicate that Husband and Wife intended that: (1) If Daughter 2 or

Daughter 3 is predeceased, their respective shares should be held in trust for the children of Daughter 2 or Daughter 3 until those children reach the age of 25; (2) In the event a grandchild dies before receiving full distribution of that grandchild's share, that share should pass to the grandchild's issue by right of representation; (3) A separate trust should be provided for each grandchild; and (4) All children of Daughter 3 who are born and living at the time of surviving spouse's death should be beneficiaries of the trust provided for in paragraph B.6. Accordingly, based on the facts presented and the representations made, we conclude that the reformation of Trust is consistent with applicable State law that would be applied in the highest court of State. Thus, the proposed reformation will not cause either the Marital Trust or the Residual Trust to lose its exempt status for purposes of the GST tax.

The trustee also proposes to modify Trust as follows: (1) Daughter 1 will be provided with \$1,000 per month and such additional amounts of the net income or principal, or both, of her trust as the trustee, in its sole discretion, deems necessary for Daughter 1's support, health, maintenance, or education, in her accustomed standard of living; (2) Successor trustee provisions will be provided for the trust for Daughter 3's children; and (3) Transfers to great-grandchildren or more remote descendants are to be done in accordance with State's UTMA. The proposed modifications of Trust will not result in a shift of any beneficial interest in Trust to any beneficiary who occupies a generation lower than the persons holding the beneficial interests prior to the modification. Further, the modifications of Trust will not extend the time for vesting of any beneficial interest in Trust beyond the period provided for in the original trust. Accordingly, based on the facts submitted and representations made, we conclude that the proposed modifications will not cause either the Marital Trust or the Residual Trust to lose its exempt status for purposes of the GST tax.

Rulings 4 and 5

Section 2501 provides that a tax is imposed for each calendar year on the transfer of property by gift during the calendar year.

Section 2511(a) provides that the gift tax applies whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 2512(a) provides that if the gift is made in property, the value thereof at the date of the gift is considered the amount of the gift.

Section 2512(b) provides that where property is transferred for less than an adequate consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration is deemed a gift.

In this case, an examination of the relevant trust instruments and representations of the parties indicate that certain provisions, resulting from scrivener's error, were contrary to the intent of the Trustors. Accordingly, based on the facts presented and the representations made, we conclude that the reformation of Trust is consistent with applicable State law that would be applied in the highest court of State. Thus, the proposed reformation will not give rise to any gift tax liability for any party.

Furthermore, the interest of each beneficiary's interest in Trust will remain the same after the proposed modification as it was prior to the modification. Accordingly, based on the facts submitted and the representations made, we conclude that the proposed modification will not give rise to any gift tax liability for any party.

Rulings 6 and 7

Section 61 provides that gross income means all income from whatever source derived, including gains derived from dealings in property. See section 1.61-6 of the Income Tax Regulations.

Section 1001(a) provides that the gain from the sale or other disposition of property is the excess of the amount realized over the adjusted basis provided in section 1011 for determining gain, and the loss is the excess of the adjusted basis provided in section 1011 for determining loss over the amount realized. Under section 1001(c), the entire amount of gain or loss must be recognized, except as otherwise provided.

Section 1.1001-1(a) provides that except as otherwise provided in subtitle A, the gain or loss realized from the exchange of property for other property differing materially either in kind or in extent, is treated as income or as loss sustained.

A partition of jointly owned property is not a sale or other disposition of property where the co-owners of the joint property sever their joint interests, but do not acquire a new or additional interest as a result of the transaction. Thus, neither gain nor loss is realized on a partition. See Rev. Rul. 56-437, 1956-2 C.B. 507.

An exchange of property results in the realization of gain or loss under section 1001 if the properties exchanged are materially different. Cottage Savings Association v. Commissioner, 499 U.S. 554 (1991). Properties exchanged are materially different if the properties embody legal entitlements "different in kind or extent" or if the properties confer "different rights and powers." Id. at 565. In Cottage Savings, the Court held that mortgage loans made to different obligors and secured by different homes did embody distinct legal entitlements, and that the taxpayer realized losses when it exchanged interests in the loans. Id. at 566. In defining what constitutes a "material difference" for purposes of section 1001(a), the Court stated that properties are "different" in the sense

that is "material" so long as their respective possessors enjoy legal entitlements that are different in kind or extent. Id. at 564-65.

In the present case, the reformations and modifications of the Marital Trust and the Residual Trust will be retroactive to the date the trusts were created. The beneficiaries of the Marital Trust and the Residual Trust currently have the same property interests and legal entitlements as they had before the reformation and modification of the trusts. Accordingly, based on the facts presented and the representations made, it would be consistent with Cottage Savings to find that the interests after the reformations and modifications to the trusts will not differ materially from the interests before the reformations and modifications. Thus, the reformations and modifications to the trusts do not give rise to a realization of income to the beneficiaries or the trusts under sections 61 or 1001.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely yours,

Katherine Mellody
Senior Technician Reviewer, Branch 4
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure:

Copy of letter for section 6110 purposes